

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
1998 Biennial Review --)	CC Docket No. 98-137
Review of Depreciation Requirements)	
for Incumbent Local Exchange Carriers)	
)	
Ameritech Corporation Telephone Operating)	CC Docket No. 99-117
Companies' Continuing Property Records)	
Audit, <i>et. al.</i>)	
)	
GTE Telephone Operating Companies)	AAD File No. 98-26
Release of Information Obtained During)	
Joint Audit)	
)	

MCI WORLDCOM COMMENTS

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MCI WorldCom, Inc. (MCI WorldCom) hereby submits its comments on the Further Notice of Proposed Rulemaking (Notice) in the above-captioned proceeding. MCI WorldCom urges the Commission to terminate this rulemaking without adopting the proposed relief because to grant the relief sought would adversely affect the development of local competition, create unnecessary and unsupportable risks of increases in intrastate and interstate rates, and is likely to lead to increases in universal service high cost support that are not warranted.

I. Introduction and Summary

In the December, 1999 Depreciation Order, the Commission indicated that it “would be appropriate to grant a waiver of [the Commission’s] depreciation prescription process for certain price cap LECs in certain instances.”¹ Specifically, the Commission indicated that such a waiver “may be approved” if a LEC voluntarily (1) agreed to adjust the net book costs on its regulatory books to the level currently reflected in its financial books by a below-the-line write-off; (2) agreed to use the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) agreed to forego the opportunity to seek recovery of the write-off through a low-end adjustment, an exogenous adjustment, or an above-cap filing; and (4) agreed to submit certain information that the Commission requires in order to maintain realistic ranges of depreciable life and salvage factors for the major plant accounts.²

In a March 3, 2000 letter, the incumbent local exchange carrier (ILEC) members of the Coalition for Affordable Local and Long Distance Service (CALLS) informed the Commission that they intended to file a joint petition for waiver of the Commission’s depreciation rules.³ The ILEC members of CALLS characterized their depreciation

¹1998 Biennial Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, Report and Order and Memorandum Opinion and Order, CC Docket No. 98-137; ASD 98-91, released December 30, 1999 at ¶ 25 (Depreciation Order).

²Id.

³Letter from Frank J. Gumper, Bell Atlantic, Robert T. Blau, BellSouth, Donald E. Cain, SBC, and Alan F. Ciamporzero, GTE, to Lawrence Strickling, Chief, Common Carrier Bureau, March 3, 2000 (ILEC March 3 Letter).

proposal as “an effort to build upon [the] new regulatory framework” created by CALLS.⁴

While the ILECs stated that their joint waiver request would be “consistent with the framework set forth in the Depreciation Order,”⁵ the proposal they sketched out in their letter differs in key respects from the Depreciation Order’s waiver conditions. Most importantly, the ILECs propose to eliminate the difference between the ILECs’ regulatory and financial depreciation reserve levels using a five-year above-the-line amortization, not the one-time below-the-line write-off required by the the Depreciation Order’s waiver conditions.

The Commission states that it has adopted the Notice because the ILECs’ proposed joint waiver request would have affected almost the entire class of carriers subject to the Commission’s depreciation rules. However, the Notice contains no proposals, tentative conclusions, or substantive policy discussion. The Commission simply states that it is initiating the rulemaking “to evaluate the conditions under which [the Commission’s] existing depreciation rules may be eliminated or changed for all price-cap carriers.”⁶ The Commission also seeks comment on whether, if the RBOCs and GTE bring their regulatory book balances to the levels of their financial book balances, the continuing property record (CPR) audit findings are rendered moot.⁷

As is shown below, eliminating the Commission’s depreciation rules for all price

⁴Id.

⁵Id.

⁶Notice at ¶ 3.

⁷Notice at ¶ 15.

cap ILECs at this early stage in the development of local exchange and exchange access competition would be contrary to Commission precedent, contrary to the Commission's statutory responsibilities, and contrary to the public interest. The Commission's depreciation rules play a key role in ensuring that rates are just and reasonable, by allowing the Commission and the public to monitor the ILECs' financial performance and by preventing inappropriate triggering of the low-end adjustment or unjustified above-cap filings. The Commission's depreciation rules also play a key role in furthering the Commission's universal service goals and the development of local competition. Twenty-four states have used the Commission's prescribed projection lives and salvage factors, or similar state-prescribed factors, in developing rates for interconnection and unbundled network elements (UNEs).⁸

Under no circumstances should the Commission adopt the ILECs' proposal for a five-year above-the-line amortization. Regardless of any commitments made by the ILECs, a five-year above-the-line amortization would create a recovery opportunity for the ILECs and create a substantial risk of increased interstate and intrastate rates. There is no evidence in the ILECs' letter or the Commission's Notice to support the creation of such a recovery opportunity.

There is nothing about the CALLS plan that justifies any change in the Commission's depreciation rules at this time or justifies a Commission decision to sweep the CPR audit results under the carpet. The CALLS plan does not change the fact that the ILECs remain dominant carriers, or change the fact that they will still be free to claim a

⁸Depreciation Order at ¶ 69.

low-end adjustment at any time, or change the fact that many states rely on the Commission's depreciation expertise in setting interconnection and UNE rates.

The only connection between CALLS and depreciation regulation, or between CALLS and the CPR audits, is that the ILECs believe they have an opportunity to extract favorable decisions from the Commission in exchange for modifications to the original CALLS plan. But, as MCI WorldCom showed in its comments on the modified CALLS plan, the modified CALLS plan is, at best, a modest improvement over the original plan.⁹ The ILECs have made only minimal concessions, and even the modified CALLS plan would still provide the ILECs with more revenue than the current rules. For the Commission to grant the ILECs near-complete freedom from depreciation regulation and absolve the ILECs from any consequences from their massive and ongoing violations of the Commission's CPR rules is far too high a price to pay for the modified CALLS plan.

The ILECs also see depreciation deregulation as an opportunity to obscure, in a fog of accounting changes, the favorable impact that the CALLS plan will have on their earnings over the next five years. This explains, in part, why the ILECs are seeking to use a five-year "above-the-line" amortization, with the amortization expense included in their earnings calculation, to eliminate the differential between their financial and regulatory books. By making it difficult for the Commission to get a clear picture of the ILECs' financial performance over the next five years, the proposed depreciation changes would also make it more difficult for the Commission to reassert effective control over ILEC earnings and rates at the end of the CALLS plan's nominal five-year life.

⁹MCI WorldCom Comments in CC Docket No. 96-262, April 3, 2000, at 21-31.

II. The Commission Should Not Adopt the ILECs' Proposal for a Five-year Above-the-Line Amortization

A. There is No Basis for Recording the Adjustment "Above-the-Line"

In their March 3, 2000 letter, the ILECs propose that they be permitted to eliminate the differential between their "financial" and "regulatory" reserve levels using a five-year "above-the-line" amortization.¹⁰ The ILECs state, however, that they would commit "not to seek recovery of the interstate amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing."¹¹ In the Notice, the Commission asks whether an above-the-line amortization, combined with a commitment not to seek recovery of the amortization and not to base any application for federal or state rate increases on any portion of the amortization over the course of the five-year period, adequately protects consumers from adverse rate impacts and otherwise meets the policy goals of the Depreciation Order.¹²

The Commission need not even reach the question of whether the ILECs' "commitment" not to seek recovery of amortization expense recorded "above-the-line" is a sufficient safeguard. Regardless of any commitments made by the ILECs, there is no basis for according "above-the-line" treatment to any expense associated with adjusting the ILECs' regulatory net book costs to their financial net book costs. Treating this

¹⁰This differential dates from 1993-1995, when the largest price cap ILECs announced that they would no longer rely on SFAS-71. This resulted in a substantial write down in plant assets in the companies' financial statements. Depreciation Order at ¶ 26 n.79.

¹¹ILEC March 3 Letter at 2.

¹²Notice at ¶ 12.

expense as “above-the-line” would be contrary to the well-established principle that a carrier’s revenue requirement may not include “any expense incurred as a result of carrier conduct that cannot reasonably be expected to benefit ratepayers.”¹³

Expenses associated with adjusting the ILECs’ regulatory net book costs to their financial net book costs cannot “reasonably be expected to benefit ratepayers.” Such expenses, whether a one-time adjustment or an amortization, would represent an acceleration of the return of capital. Accelerating the return of capital would provide no benefit to ratepayers because, as the Commission concluded only last December, the Commission’s current depreciation practices already permit appropriate recovery of capital.¹⁴ Under these circumstances, accelerating the return of capital could only harm ratepayers during the five-year amortization period.

The Commission has permitted the ILECs to accelerate the return of capital only when it has found that there was a reserve deficiency -- a situation that clearly does not exist today. As the Commission observed in the Depreciation Order, the ILECs’ depreciation reserves are at 51 percent, an all-time high, and have increased for each of the past five years.¹⁵ The Commission stated that it “[did] not agree that the incumbent LECs’ plant is underdepreciated.”¹⁶

¹³Accounting for Judgments and Other Costs Associated with Litigation, Report and Order, 12 FCC Rcd 5112, 5124 (¶ 21, n.62) (Litigation Costs Order).

¹⁴Depreciation Order, ¶¶ 14-18.

¹⁵Depreciation Order at ¶ 16.

¹⁶Depreciation Order at ¶ 65.

B. The ILEC “Commitment” is Not a Substitute for Recording the Adjustment “Below-the-Line”

An ILEC “commitment” not to seek recovery of any amortization expense through certain interstate or intrastate mechanisms would not be an adequate substitute for eliminating the differential between the ILECs’ financial and regulatory books correctly — through a one-time below-the-line adjustment. There is a fundamental inconsistency between the ILECs’ insistence that any amortization expense be recorded “above-the-line” and the ILECs’ “commitment” not to seek recovery of the amortization expense. After all, accounting for an expense “above-the-line” creates the rebuttable presumption that the expense will be allowed in the revenue requirement and charged to ratepayers. MCI WorldCom can only assume that the ILECs do intend to seek recovery of the amortization expense in some manner.

The commitment outlined in the ILECs’ March 3, 2000 letter is vague in several respects. For example, as the Commission observes in the Notice, it is not clear whether the ILECs’ commitment extends to the recovery of the intrastate portion of the amortization.¹⁷ The proposed amortization would give the ILECs a powerful new argument in favor of increasing state rates, and the Commission has given the states almost no opportunity — only two weeks — to comment on this matter. And, even if the ILECs made a commitment regarding intrastate rates to the Commission, it is not clear how the Commission could enforce such a commitment.

The March 3, 2000 letter is also vague in that it only promises that the ILECs will

¹⁷Notice at ¶ 10 n.25.

not seek recovery “through a low-end adjustment, an exogenous adjustment, or an above-cap filing.”¹⁸ MCI WorldCom notes that the ILECs have proposed other mechanisms for recovering the alleged depreciation reserve deficiency. For example, in its 1997 comments in the access reform proceeding, USTA argued that the Commission should allow the ILECs to recover the alleged reserve deficiency from interexchange carriers through a “bulk billing” mechanism.¹⁹

Similarly, it is not clear how closely the ILECs’ commitment is tied to the CALLS plan. In their letter, the ILECs state that they are making their commitment in the “context” of the CALLS plan’s “specified agreed-upon path for the level of price caps over the next five years.”²⁰ Even if the ILECs’ commitment not to seek recovery of the amortization expense is firm with respect to the five-year duration of the CALLS plan, it is not clear whether the ILECs intend to seek recovery of the differential between their financial and regulatory books at a later date. And it is not clear if the ILECs are reserving the right to seek recovery of the amortization expense if the CALLS plan is not adopted, or is not adopted in exactly the same form as proposed in the CALLS March 8, 2000 ex parte²¹, or the Commission takes any action over the next five years that changes the level of ILEC revenue recovery from that envisioned by CALLS.

¹⁸ILEC March 30 Letter at 2.

¹⁹USTA Comments, CC Docket No. 96-262, January 29, 1997, at 78.

²⁰ILEC March 30 Letter at 2.

²¹Letter from John T. Nakahata, Harris, Wiltshire & Grannis LLP, to Magalie R. Salas, FCC, March 8, 2000.

C. Even if the ILECs' Commitment with Respect to Recovery of the Amortization Expense is Firm, a Five-Year Amortization is Not in the Public Interest

Even if the amortization expense could properly be recorded “above-the-line,” and the ILECs’ commitment not to seek recovery of the amortization expense were firm, the ILECs’ proposal for a five-year amortization would still not be in the public interest. One purpose of the one-time write-off outlined in the Depreciation Order is that it would mitigate the upward pressure placed on ILEC revenue requirements if ILECs were permitted to use higher “financial” depreciation rates. The write-off would reduce the size of the ILECs’ rate base, thus offsetting part of the effect that increased depreciation expense would have on ILEC revenue requirements. As the Commission discussed in the Depreciation Order, the requirement for a one-time write-off “provide[s] assurance that carriers do not engage in a practice that would disadvantage consumers and competition by using high financial depreciation rates with high regulatory net book costs”²²

The ILECs’ proposal for a five-year amortization would allow the ILECs to use high financial depreciation rates with high regulatory net book costs. Because the ILECs’ net book costs would take five years to fall from “regulatory” to “financial” levels, the upward pressure on ILEC revenue requirements from increased depreciation expense would not be offset immediately by the effect of a lower rate base. The combination of “financial” depreciation expense and a rate base above “financial” levels could depress ILEC reported earnings sufficiently to trigger low-end adjustments or to

²²Depreciation Order at ¶ 26.

support a claim for an above-cap filing. Any increase in ILEC revenue requirements could also have an impact on rural carriers' high-cost support.²³ Thus, even if the ILECs do not seek recovery of the amortization expense itself, the ILECs' proposal for a five-year amortization does not "adequately protect consumers from adverse rate impacts and otherwise meet the policy goals of the Depreciation Order."²⁴

III. At This Early Stage in the Development of Local Competition, the Commission Cannot Deregulate Depreciation Practices for all Price Cap ILECs

The Commission states that "the primary goal of this proceeding is to determine whether there are circumstances under which [the Commission's] depreciation requirements could be eliminated for price-cap carriers in a manner that serves the public interest."²⁵ The Notice contains no proposals or tentative conclusions. However, reading between the lines, the Commission appears to be asking whether the waiver conditions outlined in the Depreciation Order would, if converted to industry-wide requirements or modified in the manner suggested by the ILEC March 3 Letter, allow the elimination of the Commission's depreciation rules for all price cap ILECs.

For the Commission to eliminate its depreciation rules for all price cap ILECs at this early stage in the development of local competition would be contrary to Commission precedent, the Commission's statutory obligations, and the public interest. No

²³Depreciation Order at ¶ 29.

²⁴Notice at ¶ 12.

²⁵Notice at ¶ 11.

“conditions” or “safeguards” can adequately protect ratepayers from the risk of interstate and intrastate rates that are not just and reasonable or protect against the substantial risk of harm to universal service or local competition.

A. The Deregulation of ILEC Depreciation Would Be Contrary to Precedent

The Commission has consistently stated that further deregulation of the ILECs’ depreciation practices should be linked to the development of competition.²⁶ In this proceeding, however, the Commission is proposing to eliminate its depreciation rules even though (1) the Commission continues to regulate the ILECs as dominant carriers; (2) there is absolutely no evidence that competition is constraining the ILECs’ pricing of interstate services;²⁷ and (3) the Commission’s own statistics show that the ILECs’ market share of the local exchange and exchange access market is 96 percent “even under the most expansive definition of local service competition.”²⁸

For the Commission to eliminate depreciation regulation for all price cap ILECs while they remain dominant carriers would be completely inconsistent with Commission precedent. The Commission would be providing the ILECs — dominant carriers with a 96 percent market share — with relief that it denied to AT&T in 1989 (when AT&T’s

²⁶Depreciation Order at ¶ 52.

²⁷Without exception, the ILECs are pricing at the maximum permitted by the Commission’s price cap rules.

²⁸Industry Analysis Division, Local Competition: August 1999 at 1.

market share was 67.5 percent²⁹) and in 1993 (when AT&T's market share had fallen to 58.1 percent and only one basket of services remained under price cap regulation).³⁰ In fact, the Commission would be providing the ILECs with relief that was not provided to AT&T until it was declared nondominant in 1995.

There would be no reasoned basis for the Commission to depart from the AT&T precedent. To the extent that there are differences between the AT&T and ILEC price cap plans, such as the low-end adjustment mechanism, these differences justify closer oversight of ILEC depreciation practices than was the case for AT&T. Other differences between the ILECs and AT&T, such as the fact that the ILECs control bottleneck facilities and are subject to section 251(c) interconnection obligations, also warrant closer oversight of ILEC depreciation practices.

The elimination of depreciation regulation, even if accompanied by a requirement that the ILECs use their financial depreciation rates and factors for regulatory accounting, would be inconsistent with the Commission's previous findings that the ILECs' financial depreciation lives are inappropriate for regulatory accounting purposes. Only last December, in the Depreciation Order, the Commission stated that it "disagree[d] with the incumbent LECs' contention that the Commission should conform its depreciation practices to other shorter lives allowed by . . . the Securities and Exchange

²⁹Industry Analysis Division, Long Distance Market Shares, June 1998, Table 3.2.

³⁰Modification of the Commission's Depreciation Prescription Practices As Applied to AT&T and The Prescription of Revised AT&T Depreciation Rates, Memorandum Opinion and Order, 4 FCC Rcd 8567, 8570 (1989); Simplification of the Depreciation Prescription Process, Report and Order, 8 FCC Rcd 8025, 8062-8063 (1993).

Commission.”³¹ The Commission found that its prescribed lives were appropriate, with the exception of one account, and rejected ILEC arguments that it allow shorter lives.³²

Nothing in the Depreciation Order supports the elimination of depreciation regulation for all price cap ILECs at this early stage in the development of local competition. The Depreciation Order simply states what has always been true -- that individual ILECs are free to seek a waiver of the Commission’s depreciation rules -- and establishes minimum commitments that ILECs seeking such a waiver have to make. The Commission cannot now deregulate depreciation practices for all price cap ILECs by simply converting the waiver “conditions” outlined in the Depreciation Order to industry-wide “requirements.” First, the Depreciation Order makes clear that compliance with the four minimum conditions outlined in the Depreciation Order would not, by itself, be sufficient to warrant waiver of the Commission’s rules.³³ Second, by referring the ILECs to the waiver process, the Depreciation Order confirms the validity of the Commission’s depreciation rules.³⁴ There would be no reasoned basis for the Commission to now — only four months after the adoption of the Depreciation Order — eliminate its

³¹Depreciation Order at ¶ 17.

³²Depreciation Order at ¶¶ 13-18.

³³Depreciation Order at ¶ 25. The Commission made clear that carriers would also have to demonstrate “good cause” for a waiver. This requires a showing that “special circumstances” warrant a deviation from the general rule, that such deviation serves the public interest, and that the waiver is consistent with the principles underlying the rule.

³⁴WAIT Radio v. FCC, 418 F.2d 1153, 1158 (D.C. Cir. 1969) (“the very essence of waiver is the assumed validity of the general rule”).

depreciation rules for all price cap ILECs.

B. Deregulation of ILEC Depreciation Practices Would be Contrary to the Commission's Statutory Obligations and the Public Interest

At this early stage in the development of local competition, the deregulation of depreciation for all price cap ILECs would be contrary to the Commission's statutory obligations and contrary to the public interest. The public interest concerns cannot be mitigated by simply applying, on an industry-wide basis, conditions or safeguards such as those outlined in the Depreciation Order.

1. Allowing the ILECs to Use Financial Depreciation Rates and Factors Would Be Inconsistent with the Commission's Statutory Duty to Ensure Just, Reasonable, and Nondiscriminatory Rates

As the Commission has explained on many occasions, "accurate identification of costs is central to the Commission's ability to carry out its responsibilities."³⁵ In particular, reliable and consistent reporting of ILEC earnings is essential to the Commission's ability to carry out its responsibilities under section 201 of the Act. The Commission must be able to determine whether its regulations are ensuring a "reasonable balancing" of the "investor interest in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exploitative rates."³⁶

Today, the Commission's depreciation rules ensure that the earnings reported on the ILECs' Form 492A rate of return reports provide a reliable and consistent basis for

³⁵See, e.g., Litigation Costs Order, 12 FCC Rcd at 5116 (1997) (emphasis added).

³⁶Jersey Cent. Power & Light v. FERC, 810 F.2d 1168, 1177-1178 (D.C. Cir. 1987).

tracking ILEC performance. If the Commission were to deregulate ILEC depreciation practices, the ILECs' would have too much discretion in their reporting of depreciation expense -- the largest single expense item on the ILECs' books. A requirement that ILECs use financial rates and factors for regulatory accounting would not be sufficient to protect the public interest. The Commission has consistently found that generally accepted accounting principles (GAAP) allow the ILECs too much latitude in determining their depreciation expense.³⁷ And the Commission has consistently concluded that GAAP's conservatism principle does not offer adequate protection for ratepayers in the case of depreciation accounting.³⁸

There is no merit to the Depreciation Order's suggestion that, as long as the Commission maintains "realistic" life ranges, the Commission could always "correct" "unrealistic" depreciation expense and earnings reported by the ILECs.³⁹ First, because reliable and consistent reporting of ILEC earnings is so fundamental to the Commission's exercise of its statutory obligations, the Commission should not put itself in the position of having to "correct" ILEC earnings reports as long as the ILECs remain dominant carriers with 96 percent of the market. Furthermore, while such a correction is perhaps feasible as a matter of mathematics, the reality is that any attempt by the Commission to rely on corrected earnings figures would become mired in controversy. Parties seeking to rely on corrected earnings figures in a section 208 complaint proceeding would face the

³⁷See, e.g., Depreciation Order at ¶ 48.

³⁸Id.

³⁹Depreciation Order at ¶ 40.

same hurdle. Consequently, as long as the ILECs are regulated as dominant carriers, the Commission's depreciation rules must ensure that ILEC earnings reports provide a reliable and consistent basis for the Commission to determine whether its regulatory methods are maintaining rates within the "zone of reasonableness."

2. Allowing the ILECs to Use Financial Depreciation Rates and Factors Could Trigger a Low-End Adjustment

As the Commission acknowledged in the Depreciation Order, reliance on GAAP is not sufficient to prevent excessive depreciation expense that could reduce an ILEC's rate of return below the low-end adjustment mark.⁴⁰ None of the Depreciation Order's four conditions addresses this risk directly. ILECs would remain free to claim a low-end adjustment if they reported earnings below 10.25 percent. MCI WorldCom notes that, in contrast to the original CALLS plan, the modified CALLS plan retains the low-end adjustment mechanism.

At this early stage in the development of local competition, continued depreciation regulation is necessary to prevent inappropriate triggering of the low-end adjustment mechanism and to guard against rates that are not just and reasonable. The Depreciation Order's suggestion that the Commission could scrutinize the ILECs' depreciation decisions on a case-by-case basis is not viable.⁴¹ Even if the Commission is able to maintain realistic life and salvage estimates to use in evaluating an ILEC's claimed depreciation expense, any attempt to disallow a low-end adjustment resulting

⁴⁰Depreciation Order at ¶ 48.

⁴¹Depreciation Order at n.84.

from use of financial depreciation factors and rates would become mired in controversy.

If the Commission permits all of the price cap ILECs to use financial depreciation rates and factors for regulatory accounting — which it should not — the Commission should protect ratepayers by eliminating the low-end adjustment mechanism. This step would be consistent with the Commission's finding, in the Pricing Flexibility Order, that ILECs obtaining regulatory flexibility should not be afforded any rate-of-return-based protection.⁴² At a minimum, the Commission should eliminate the automatic aspect of the low-end adjustment mechanism, requiring the ILEC to first demonstrate that its depreciation expense is proper.⁴³

3. Allowing the ILECs to Use Financial Depreciation Rates and Factors Would Harm Universal Service and Local Competition

The Commission's prescribed projection lives and salvage parameters are used in the Commission's synthesis cost model to estimate high-cost universal service support and by many state commissions to calculate interconnection and UNE rates. Twenty-four state commissions have used FCC-prescribed projection lives, or similar state-prescribed factors, to calculate prices for UNEs.⁴⁴

Allowing the ILECs to use financial depreciation rates for regulatory accounting poses a substantial risk to universal service and to the development of local competition.

⁴²Access Charge Reform, Fifth Report and Order, 14 FCC Rcd 14221 at ¶ 164 (Pricing Flexibility Order).

⁴³See the Commission's discussion of BellSouth's proposal. Depreciation Order at ¶ 46.

⁴⁴Depreciation Order at ¶ 69.

The Notice's suggestion that the Commission could require that all ILECs continue submitting information necessary to update the Commission's depreciation parameters would do little to offset this risk. First, by allowing the ILECs to use financial depreciation parameters for regulatory accounting, the Commission could inadvertently bolster the ILECs' claim that their financial depreciation factors should be used in cost models as well -- regardless of whether the Commission continues to maintain realistic ranges of depreciable life and salvage factors. Second, it is not in the public interest, at this early stage in the implementation of the 1996 Act's universal service provisions and in the development of local competition, for the Commission to rely on an untested procedure for updating key depreciation parameters used in the cost models.

If the Commission does allow the ILECs to use financial depreciation parameters for regulatory accounting purposes -- which it should not -- then it should, at a minimum, take the following steps:

First, the Commission should make clear that it is not reconsidering its previous conclusions that its life and salvage ranges are the best forward-looking estimates of these parameters,⁴⁵ and that it is not reconsidering its previous conclusion that the depreciation values used in the ILECs' financial reporting are not compatible with the accurate estimation of the cost of providing services that are supported by the federal high-cost mechanism.⁴⁶

⁴⁵See Depreciation Order at ¶ 61.

⁴⁶See Federal State Joint Board on Universal Service, Tenth Report and Order, CC Docket No. 96-45, rel. November 2, 1999, at ¶ 429.

Second, the Commission should adopt the Depreciation Order's fourth waiver condition as a rule, requiring all ILECs to submit information about network retirement patterns, forecast additions and retirements for major network accounts, replacement plans for digital central offices, and information concerning relative investments in fiber and copper cable.⁴⁷

4. The Commission Has Not Considered the Impact on Intrastate Rates

It is not in the public interest for the Commission to rush to adopt changes to its depreciation rules that could have far-reaching consequences for intrastate rates. Some state commissions continue to participate in “three-way meetings” with the Commission and the ILECs, and most prescribe depreciation parameters for intrastate ratemaking which generally agree with those prescribed by the Commission. Indeed, some state commissions lack the resources to independently evaluate LEC filings and rely heavily upon the Commission’s expertise and determinations. The maintenance of just and reasonable intrastate rates is thus often dependent on Commission regulation of depreciation.

The Commission states in the Notice that “because many of the state regulatory commissions use our cost models and often rely on our depreciation prescriptions for state ratemaking purposes, we seek to ensure that elimination of our depreciation requirements will not have any adverse impact at the state level.”⁴⁸ But the Notice’s policy discussion is limited to a recitation of the waiver conditions outlined in the

⁴⁷Depreciation Order at ¶ 34.

⁴⁸Notice at ¶ 11.

Depreciation Order, none of which address the potential impact of depreciation deregulation on intrastate ratemaking. And the unreasonably short comment cycle established for this proceeding -- belies the Commission's claim that it is seeking input from the states.

IV. The RBOC CPR Audits Are Not Rendered Moot

The RBOC CPR audit findings would not be rendered moot if the RBOCs bring their regulatory book balances to the levels of their financial book balances. A change in the level of the RBOCs' reserve levels is irrelevant to the question of whether the RBOCs plant balances were inflated, and continue to be inflated, by the RBOCs' deficient CPR practices, and is irrelevant to the question of whether the RBOCs have violated, and continue to violate, the Commission's CPR rules.

Elimination of the differential between the RBOCs' financial and regulatory reserve levels would in no way offset the effects of the RBOCs' plant overstatement, as the Commission appears to suggest in the Notice. First, eliminating this differential would do nothing to correct the RBOC price cap indexes that were inflated by the ILECs' plant overstatement. And, from an accounting standpoint, the depreciation-related write-off proposed in the Notice and the write-off recommended by the Commission's auditors would affect entirely separate accounts. The write-offs proposed in the Notice would affect the ILECs' depreciation reserve, whereas the write-offs recommended by the auditors would primarily affect their gross plant.

Eliminating the differential between the ILECs' financial and regulatory

depreciation reserve levels would also do nothing to correct the deficient CPR practices uncovered by the auditors. The auditors found that the RBOCs had violated a range of Part 32 rules, and found further that the problems revealed in the audits “are longstanding and unlikely to self-correct.”⁴⁹ For this reason, the auditors recommended that the RBOCs engage independent auditors to review their practices, procedures, and controls for maintaining their CPRs, and also recommended that the RBOCs develop and submit to the Commission for approval plans of corrective action for maintenance of their CPRs.⁵⁰ The Commission cannot terminate the CPR audits as long as the RBOCs CPR practices remain deficient.

V. Conclusion

At this early stage in the development of local competition, there are no conditions under which the Commission can eliminate depreciation regulation for all price cap ILECs.

Respectfully submitted,
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⁴⁹See, e.g., SWBT Audit Report at ¶ 36.

⁵⁰Id. at ¶ 44.